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## **THE ECONOMIC AND LEGAL CONSEQUENCES BETWEEN CHOOSING PUBLIC DEBT OR INCREASE TAX BURDEN**

### **I. Introduction**

There are two ways of limiting budget deficit by the authorities. The first one is to take public debt and the other is to increase tax rates. Each of these methods entails specific economic consequences. In case of taking the public debt the most important factor is the subject and object scope of it and the limits of the public debt (so called fiscal rules). The other way of increasing budget incomes is to increase tax rates. Tax is an obligatory tribute. Therefore, the taxpayer is obliged to pay it. What must be taken into consideration by the authorities is the economic consequences of both these ways of increasing budget revenues. Therefore, the choice between taking the public debt and increasing tax burden depends on many different features, such as: the contemporary economic situation, the economic policy, or the limits of public debt (if they are close to be exceeded it is difficult to take another public loans).

The article analyzes the issues connected with the public debt and taxation, such as: economic, financial, and legal definitions of public debt (especially in Polish and European financial law), limits of the public debt and chosen economic consequences of public debt and taxation.

### **II. Economic, financial, and legal definitions of public debt**

#### **II.1. Economic and financial definition of the public debt**

There are multiple definitions of public debt in the economic literature. *D. Begg, S. Fischer, R. Dornbusch* define public debt as the sum of the state's borrows which are to repay<sup>1</sup>. According to another definition, public debt is the amount of interest-bearing liabilities the state toward the society<sup>2</sup>. In Polish economic literature, public debt are financial liabilities

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<sup>1</sup> BEGG, DAVID – FISCHER, STANLEY, DORNBUSCH – RUDIGER: *Ekonomia* [Economics], Vol. 2, Warsaw, 1995. 68. p.

<sup>2</sup> BARRO, ROBERT: *Makroekonomia* [Macroeconomics], Warsaw, 1997. 638. p.

of the authorities (*i.e.* state, municipal and local) connected with loans<sup>3</sup>. Another definition defines the public debt as total liabilities of legal entities belonging to the public sector to entities outside the public sector or the total amount of liabilities, which must be repaid from public funds<sup>4</sup>.

In Polish finance literature, public debt was also defined in many ways. For example, *M. Bitner* and *E. Chojna – Duch* define it as aggregated and consolidated value of the liabilities of entities belonging to the public sector (from different titles)<sup>5</sup>. Another author, *C. Kosikowski* defines the public debt as liabilities the entities belonging to the public sector connected with financing of the deficit of the public sector and the budget deficit<sup>6</sup>

## II.2 The legal definition of public debt in the Polish finance law (the Constitution of the Republic of Poland<sup>7</sup>, Polish Finance Act<sup>8</sup>)

The legal definition of public debt is “the state public debt”. For the first time, this definition has been used in the article 216 paragraph 5 of the Constitution of the Republic of Poland of 2<sup>ND</sup> April 1997. Consequently, this definition was used in all Public Finance Acts, which were issued afterwards (in 1998, 2005 and 2009). Currently, the Act of 29th August 2009 on Public Finance is in force (further referred to as PFA). The definition of state public debt related to, among other things, a way of calculating and financing of public debt. The method for calculating the debt referred to in Article 73 paragraph 1 of PFA, according to which public debt is calculated as the nominal value of the liabilities of public sector entities after the elimination of mutual obligations between individuals in the sector (after consolidation).

In PFA public debt is classified as State Treasury debt and National/State debt. State Treasury Debt is the debt taken by the State Treasury (*i.e.* the central government sector). National/state public debt is the debt taken by the all entities belonging to the public sector (*i.e.* central government sector and the local government sector).

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<sup>3</sup> OWSIAK, Stanisław: *Finanse publiczne. Teoria i praktyka* [Public Finance. Theory and Practise], Warsaw, 2006. 330. p.

<sup>4</sup> MALINOWSKA-MISIĄG, ELŻBIETA – MISIĄG, WOJCIECH: *Finanse publiczne w Polsce* [Public Finance in Poland], Warsaw-Rzeszów, 2006. 637. p.

<sup>5</sup> BITNER, MICHAŁ – CHOJNA-DUCH, ELŻBIETA: *Dług publiczny i deficyt sektora finansów publicznych* [Public debt and the deficit of the public finance sector] In: *Prawo finansowe* [Finance Law], E. Chojna-Duch \_ H. Litwińczuk (ed.), Warsaw, 2007. 121. p.

<sup>6</sup> KOSIKOWSKI, CEZARY: *Finanse publiczne i prawo finansowe* [Public Finance and Finance Law], Warsaw, 2001. 214. p.

<sup>7</sup> The Constitution of the Republic of Poland of 2nd April, 1997, Journal of Laws (Dziennik Ustaw) No. 78, item 483 with amendments.

<sup>8</sup> The Act of 29th August 2009 on Public Finance, Journal of Laws (Dziennik Ustaw) from 2013, item 785 with amendments.

### II.3. The definition of public debt in the European finance law (Growth and Stability Pact<sup>9</sup>)

In the EU financial law, the term ‘public debt’ may be defined in connection with excessive deficit procedure (further referred to as EDP). The excessive deficit procedure is applied to all European Union member states<sup>10</sup>. It was established by Article 126 of the Treaty on the Functioning of the European Union<sup>11</sup> (further referred to as TFEU). One of the reference values of this procedure is the 60% criterion for the ratio of government debt to gross domestic product at market prices (GDP), set in Article 1 of the Protocol regarding the excessive deficit procedure and annexed to TFEU (further on called ‘Protocol’). In Article 2 of the Protocol the terms ‘public’ and ‘debt’, relating to this ratio, were specified. ‘Government’ means ‘general government, that is central, regional or local government and social security funds, to the exclusion of commercial operations’, as defined in the ESA 95 system (currently it is ESA 2010<sup>12</sup>) but regulation concerning this matter has not been changed yet. On the other hand, ‘debt’ means “total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government” as defined above. Thus, it has been clearly stated that the matter in question is the gross public debt and moreover, all mutual obligations between the sectors of general government were eliminated, that is only the consolidated value was considered. In this way, as ‘government’ the general government (S.13)<sup>13</sup> was identified, that is ‘central government’ (S.1311), ‘state government’ (S.1312), ‘local government’ (S.1313) and ‘social security funds’ (S.1314), to the exclusion of commercial operations as defined in ESA 95/ESA 2010 (which means that the general government sector is constituted solely by entities whose main activity is providing non-market services). This Regulation defines the ‘government debt’ as “the total gross debt at nominal value outstanding at the end of the year of general government (S.13), with the exception of those liabilities the corresponding financial assets of which are held by the sector of general government (S.13)”.

### III. The legal regulations applied to Poland and UE<sup>14</sup>

The Constitution of the Republic of Poland bans on contracting loans and granting guaranties and sureties resulting in the public debt exceeding 3/5 of GDP (Article 216 paragraph 5).

In the Polish Public Finance Act were established regulations on public debt such as: definitions, basic principles of issuing public debt and debt management, prudential and remedial procedures applied to public debt levels, definition of the scope of the public

<sup>9</sup> Further referred to as GPW.

<sup>10</sup> The pinpointing of this procedure was stated in the Stability and Growth Pact applied by all EU member states. Though, its restrictive part does not refer to states which are not members of the Economic and Monetary Union, being subject to derogation in that respect. OREŹIAK, Leokadia: *Finanse Unii Europejskiej* [European Union Finances], Warsaw. 2004. 59-66. p.

<sup>11</sup> Journal of Laws UE C 115 from 9.5.2005, p. 47.

<sup>12</sup> Regulations No 549/2013 of the European Parliament and the Council of 21 May 2013 on the European system of national and regional accounts in the European Union, called ESA 2010.

<sup>13</sup> The codes given in brackets refer to ESA 95.

<sup>14</sup> The Public Finance Sector Debt Management Strategy in the years 2014-2017, Warsaw, 2013. *passim*.

finance sector. In the Treaty on the Functioning of the European Union were regulated down the level of general government debt and restrictions applied to general government deficit constitute the criterion on the basis of which the Commission examines the compliance with budgetary discipline in Member States (Article 126) – specifies the so called Excessive Deficit Procedure (EDP). In the Protocol on the excessive deficit procedure annexed to the Treaty Establishing the European Community and the Treaty on the Functioning of the European Union were established the definition of general government debt and reference value of debt to GDP ratio at 60%. The Council Regulation on the Application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty Establishing the European Community includes the definition of general government debt with specification of categories of liabilities which constitute it. In the European System of Accounts (ESA 95/ESA 2010<sup>15</sup>) were established the definition of categories of financial liabilities and definition of general government sector.

#### **IV. The main differences in general government debt – Polish and EU definition**

The first difference is the scope of the public finance sector. Public Finance Act defines limited catalogue of units included in the public finance sector. The funds formed within *Bank Gospodarstwa Krajowego* (BGK), e.g.: the *National Road Fund* (KFD), the *Railway Fund* (FK) are excluded from the Polish public finance sector. In the EU regulations funds formed within *Bank Gospodarstwa Krajowego*, e.g.: the *National Road Fund* and the *Railway Fund* are included in the general government sector. Moreover, the public corporations that do not cover at least 50% of its costs by its sales are excluded from the Polish public finance sector. In ESA 2010 the scope of general government sector was no limited catalogue of units is defined.

Another difference between these two legal acts is connected with the liabilities which constitute public debt. In PFA were established liabilities such as securities (excluding shares); loans (including securities whose disposal is limited); deposits; matured payables (i.e. liabilities due but not settled). In EU regulation, there are liabilities such as matured payables; unnamed contracts connected with financing of services, goods or construction works that produce economic effects similar to loan. The restructured or refinanced trade credits (including those with original maturity of one year or less) are included in loan category.

The third difference is connected with the contingent liabilities in treatment of contingent liabilities in debt-to-GDP ratio. In Polish regulations, there are not included. The EU limitations do not take directly into account contingent liabilities generated by issued sureties and guarantees. When specific criteria are met (in line with ESA'95 rules) contingent liabilities should be treated as debt assumed by the entity which issued surety or guarantee.

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<sup>15</sup> The ESA 2010 was applied for the first time to data transmitted from 1st September 2014.

## **V. Supranational public debt and deficit limits**

The instruments which are used to limit the public debt or budget (or public) deficit are fiscal rules. Fiscal rule is defined as permanent limitation of fiscal policy, usually defined in form of synthetic total index (*i.e.* admissible) of fiscal result (budget)<sup>16</sup>. The aim of fiscal rules is *i.e.* limitation of increase of defined economic values above established limit (*e.g.* public debt, public deficit, public expenses). That is why fiscal rules can be used as one of instruments of fiscal consolidation. Literature provides with traits, which should an optimal fiscal rule possesses in order to be effective in praxis. The above-mentioned criteria refer to fiscal rules of supranational nature<sup>17</sup>.

An optimal fiscal rule should be *i.e.* simple, easy for verification, maintain financial liquidity of public authorities, should not determine optimal size of public sector, should enable functioning of automatic stabilizers of economic situation and not encourage to use tools of procyclical interaction, should have long-term character, take into consideration diverse situation of Economic and Monetary Union of the EU, should have universal character *i.e.* be used at the level of economies of respective EMU countries, and the whole Eurozone, be credible, be used unbiased and consistently<sup>18</sup>. One of conditions of efficiency of a fiscal rule is aim defined numerically *i.e.* as limitation of national fiscal policy in form of general budget results such as expenses, loans, debt. Moreover, these rules should be also connected with procedural reforms of budget institutions, which are conducive to responsible fiscal behavior. Empirical researches confirm that connection of these both kinds of rules supports maintaining budget discipline effectively<sup>19</sup>. Other requirements which should be met by a fiscal rule are *i.e.* precise determination of a budget index to which a given rule refers; providing it with a respective legal importance by standardizing it in constitution, or an act; clear premises of the fiscal rule, which is understood by the public; determination of sanctions against not obeying it and body responsible for imposing them; choice of a rule in accordance to chosen economic and financial strategy of a country in the medium and long term perspective<sup>20</sup>.

Fiscal rules are classified basing on different criteria. At present one can distinguish fiscal rules of supranational character (fiscal criteria concerning deficit of general government sector and public debt) and national fiscal rule (in particular EU countries). Fiscal rules can be also classified as: quantity rules (based on the numerical aim) and quality ones (concerning *i.e.* budget procedure), rules concerning determined economic category *e. g.* budget expenses, budget deficit, public debt, rules defined at the fiscal central and local level. Fiscal rules in a given EU country are usually determined both at the fiscal central and local level. Similar solution was applied in the Polish Fiscal Law, which standardized both fiscal rules concerning public debt (including liabilities of the whole sector of public

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<sup>16</sup> KOPITS, GEORGE – SYMANSKY, STEVEN: *Fiscal Policy Rules*, IMF, Occasional Paper 1998/162. 2. p.

<sup>17</sup> BUITER, WILLEM: *The commandments for a fiscal rule in E(M)UM*, London, 2003. 6-8. p.

<sup>18</sup> BUITER 2003, 6-8. p.

<sup>19</sup> BUTI, MARCO – GUIDICE, GABRIELE: *EMU's fiscal rules: what can and cannot be exported*, European Commission, 2002. 3-6. p.

<sup>20</sup> MARCHEWKA-BARTKOWIAK, KAMILA: *Fiscal rules*, Analyses of the Bureau of Research of Sejm 2010/ 7. 3. p.

finances also units of local authorities), as well as limit of debt referring to respective units of local authorities<sup>21</sup>.

Two fiscal rules of supranational character were standardized in the EU financial law. These are fiscal convergence criteria concerning public debt and public deficit. They are bound with so called procedure of excessive deficit defined in the Article 126 of the Treaty of Functioning of the European Union. The requirements of budget discipline (Art. 126 TFEU) are like follows. Firstly, the ratio of planned or real budget deficit to the GDP should not exceed 3% GDP, unless: the ratio decreases considerably, is stable and reaches the level close to reference value, exceeding reference value is exceptional and temporary and the ratio remains close to reference value. Secondly, the ratio of public debt- to-the-GDP should not exceed 60% of the GDP unless: the ratio decreases sufficiently and approaches reference value in satisfactory pace.

In Polish financial law, there is also the constitutional public debt rule (Article 216 paragraph 5 of the Constitution of the Republic of Poland), which is one of the main fiscal rule in Polish finance law. According to this Article "It shall be neither permissible to contract loans nor provide guarantees and financial sureties which would engender a national public debt exceeding three-fifths of the value of the annual gross domestic product." The Polish Ministry of Finance controls if above rule is obeyed.

In PFA were also established, mentioned above, the caution and sanative procedure (article 86-88 PFA).

They are activated in case when public debt exceeds the threshold of 55% and 60% GDP. Procedures mainly limit the amount of state budget deficit, local authorities' deficit, and the possibility of providing new guarantees. When debt-to-GDP-ratio exceed 55% or 60% the Council of Ministers prepares the recovery program. It shall contain: specification of the reasons for the development of the state public debt ratio (*i.e.* 55% or 60% GDP), a program of measures designed to lead to a lowering of above mentioned ratio, taking into account the analysis of quantitative limits and other legal circumstances, a three-year forecast concerning the ratio of the state public debt to the gross domestic product along with the predicted macroeconomic developments of the country. The provisions shall not apply in the case of the introduction of a state of emergency, making impossible or significantly hampering the execution of the recovery program.

## VI. Fiscal rules as an instrument of fiscal consolidation

Fiscal consolidation of public finances is connected with notion of fiscal adjustment. Periods of fiscal adjustments base on observed changes of budget deficits in relation to GDP. Nevertheless, these criteria are contractual, because fiscal consolidation can also be determined for every year in which there is positive change of budget balance<sup>22</sup>. Decrease

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<sup>21</sup> NIZIOL, KRYSZYNA: *Prawne aspekty długu publicznego*, [The legal aspects of public debt], Szczecin. 2013. *passim*.

<sup>22</sup> GUPTA, SANJEEV – CLEMENTS, BENEDICT – BALDACCI, EMANUELE – MULAS-GRANADOS, CARLOS: *Expenditure Composition, Fiscal Adjustment, and Growth in Low – Income Countries*, IMF Working Paper 2002/77. 22.p.

of basic structural deficit by at least 1.5% GDP within a year, or at least 1.2 % GDP within two years can set as an example of expansive fiscal consolidation<sup>23</sup>.

Fiscal consolidation, in a wide sense, aims at decreasing amount of budget deficit as well as amount of the public debt<sup>24</sup>. Issues concerning fiscal consolidation have become a very crucial problem at the times of economic crisis, which has led to debt crisis in many countries. However, the increase of the public debt is not only consequence of the economic crisis, but also fiscal policy of a given country, especially amount of expenses for health care and retirement pensions<sup>25</sup>.

Social and economic consequences of the economic crisis initiated number of changes in the EU Fiscal Law including ones connected with consolidation of public finances. One should pay attention to *i.e.* changes which aim at strengthening coordination of economic policies in the EU which are made on the way of strengthening of the preventive and corrective part of the Stability and Growth Pact, strengthening budget supervision in the Eurozone, as well as introduction of new frames of institutional, macroeconomic supervision. Execution of new requirements concerning preventive and corrective part of SGP by EMU countries has been strengthened, through introduction of new sanctions included in frames of the budget supervision (*i.e.* duty of placing on deposit equal to 0.2 % GDP, which could turn into fine)<sup>26</sup>. Moreover, new frames of macroeconomic supervision were introduced. Procedure of excessive disturbance of balance within which a warning mechanism is to be worked out, basing on the identification of disturbances of macroeconomic balance established on the basis of tables of macroeconomic indexes created for every EU country with indication of alarm thresholds is to be a new tool of this supervision. Sanction (reaching 0.1% GDP in the previous year) was also introduced in this case, if disciplinary actions which are undertaken earlier are not effective and successful. Introduction of so called European Semester, which aims at assuring closer coordination of economic procedures and achieving stable convergence of economic results of the member countries, constitutes subsequent change. The Council leads multi-sided supervision for coordination of economic policy in accordance with aims and requirements foreseen in the TFEU, which includes such actions, as an assessment of stability program, or program of convergence of member states, supervision which aims at prevention of disturbance of macroeconomic balance and its correction within the frames of the European Semester<sup>27</sup>.

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<sup>23</sup> BUKOWSKI, MACIEJ – KOWAL, PAWEŁ – LEWANDOWSKI, PIOTR – ZAWISTOWSKI, JULIAN: *Structure and level of expenditures and revenues of the sector of public finances and the situation at the labour market. International experiences and conclusions for Poland* [Struktura i poziom wydatków i dochodów sektora finansów publicznych a sytuacja na rynku pracy. Doświadczenia międzynarodowe i wnioski dla Polski], National Bank of Poland, Warsaw, 2005. 131-133. p.

<sup>24</sup> The OECD Economic Outlook: Sources and Methods, OECD 2001, <http://statp.oecd.org/glossary/detail.asp?ID=984> (04.06.2017).

<sup>25</sup> SUTHERLAND, DOUGLAS – HOELLER, PETER – MEROLA, ROSANNA: *Fiscal consolidation: How much, how fast and by what means?* OECD Economic Policy Papers 2012/1. 11-13. p.

<sup>26</sup> Regulation of the European Parliament and Council (UE) No 1176/2011 of 16th November 2011 in case of prevention of disturbances of macroeconomic balance and their correction (J.L. L of 2011 No 306, item. 25).

<sup>27</sup> Regulation of the European Parliament and Council (UE) No 1174/2011 of 16th November 2011 in case of enforcement of correction means of excessive of disturbances of macroeconomic balance in the Eurozone (J.L. L of 2011 No 306, item. 8).



Guidelines for EU member states, which are taken into consideration by these countries in shaping their economic, budget, employment policies before making crucial decisions concerning national budget for subsequent years, are made after assessment of these programs. If a member state does not comply with above mentioned guidelines it exposes to defined sanctions, such as ex. warning of Commission issued on the basis of Article 121 item 4 of TFEU<sup>28</sup>. These are not all changes, which aim at counteracting the debt crisis in the EU countries. Fiscal rules are instrument which was created for it. One of changes in the EU financial law in introduction of these rules along with rules of supranational character concerning public debt and deficit, also at the national level in EU countries<sup>29</sup>.

## VII. Limits on the public debt-to-GDP ratio in the Polish Public Finance Act

In the PFA were established the legal procedures regarding limits on public debt to GDP ratio. There are two thresholds connected with the debt-to-GDP ratio. If one of them will be exceeded there are established some restrictions. The first threshold is established for the ratio if in year  $x$  the public debt is greater than 55% and lower than 60%. In that case *e.g.*: it is assumed the lack of deficit or the difference between state budget revenues and expenditures in draft budget act adopted by the Council of Ministers for the year  $x+2$  must ensure the decrease in State Treasury debt to GDP ratio as compared to the ratio announced for the year  $x$ , in draft budget act adopted by the Council of Ministers for the year  $x+2$ ; no increase in salaries of public sector employees is assumed, revaluation of pensions must not exceed the CPI<sup>30</sup> level in the budgetary year  $x+1$ , ban on granting new loans and credits from the State budget is introduced. Moreover, in that case the Council of Ministers make a review of: State budget expenditures financed by foreign credits, long- term programs. The Council of the Ministers make also a review of regulations in force to propose possible legal solutions which influence state budget revenues, including VAT rates, increase of VAT<sup>31</sup> rates for subsequent 3 years is introduced. The second ratio is established for the ratio in year  $x$  is equal to or greater than 60% *e.g.*: in that situation when above mentioned procedures (in case of the ratio greater than 55%, and lower than 60%) are used, budgets of local government units for the year  $x+2$  must at least be balanced; a ban on granting new sureties and guarantees by public finance sector entities is introduced. Moreover, the Council of Ministers presents to the Parliament a remedial program with the main objective to prepare and implement actions aimed at reducing the public debt-to-GDP ratio below 60%.

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<sup>28</sup> Article 2a Regulation of the Council No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic Policies, OJ L 209, 2.8.1997, p. 1–5.

<sup>29</sup> Article 2a Regulation of the European Council No 1466/97, Council's directive 2011/85/UE of 8th November 2011 in case of requirements for budget frames of member states (J.L. UE L of 2011 No 306, item. 41).

<sup>30</sup> Consumer Price Index – one of the index of the inflation.

<sup>31</sup> Value Added Tax.



### **VIII. The reasons of taking public debt (*inter alia* budget deficit)**

In Polish financial and economic literature<sup>32</sup> as the reasons of taking the public debt usually are featured as *e.g.*: taking the public debt for the unusual economic and social purposes such as investment expenses. For example, that kind of public expense connected with the need of building the state's structure after regaining the independence of Poland in 1918. In the 1921-26 over 90% of the public debt had been incurred for this reason<sup>33</sup>. Another investment expense, which explains incurring of the public debt are this, which are necessary to build some objects for the society such as hospitals, schools, roads etc. and there are no current incomes to budget for financing this aims. Basically, the public debt should be taken for "productive" reasons in economic sense. It means it should not been incurred for consumption reason such as financing expenses which in the future will not give incomes to the budget.

In theory, the State should follow the principle of balanced budget, which tells that the budget balance is the difference between budget's revenues and spending. A positive balance is called a budget surplus, and a negative balance is called a budget deficit. It means, that the budget expense should equal budget incomes over the course of an accounting period, usually one year. Unfortunately, in many cases the source of the public debt is the budget deficit which is the difference between income and expenditure of the state budget. In fact, the main source of the public debt in Poland is the deficit of the public finance sector (equivalent of general government sector in European financial law), which is negative difference between public income and public expenditures of the public finance sector (after consolidation *i.e.* after eliminating cash flows between entities belonging to this sector).

In Polish Finance law, there is also another legal category connected with the public debt. In Polish Finance Act the budget deficit is an element of the loans needs of the State budget. The loan needs of the State budget are the financial resources necessary for financing the state budget deficit, other expenditure required for repayment of commitments drawn earlier *e.g.* repayments of acquired loans and credits, redemption of securities and other financial transactions. The main two components of the loan needs of the State budget are budget deficit and repayment of commitments drawn earlier. A deficit of the state budget may be covered with revenues derived, *inter alia*, from: the sale of Treasury securities on the domestic and foreign market, credits drawn in domestic and foreign banks, loans, from privatization of assets of the State Treasury, a surplus of the state budget from previous years.

Article 72 paragraph 1 PFA established that state public debt shall consist of commitments of the public finance sector under the following: issued securities for cash liabilities, drawn credits and loans, accepted deposits, payable commitments of budgetary units, resulting from laws and court decisions, extended guarantees and other.

In PFA Treasury securities are divided into those that may be issued as: short-term Treasury securities with an original maturity of no longer than one year (among other T-bills) and more than one year (among others government bonds). Treasury securities may be issued within the indebtedness limit defined in the Budgetary Act. The State Treasury

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<sup>32</sup> See for example GŁABIŃSKI, STANISŁAW: *Wykład nauki skarbowej* [The Lecture of Fiscal Science], Lwów, 1902. 572-574. p., RADZISZEWSKI, HENRYK: *Nauka skarbowości państwowej i gminnej*, [Fiscal Science], Warsaw, 1917. 458 – 460 p.

<sup>33</sup> ZAJDA, JÓZEF: *Długi państwowe Polski*, [The Polish Public Debts], Warsaw, 1927. 3-5. p.

may draw loans and credits only for financing the needs. The amount of drawn loans and credits may not exceed the limit of debt increase defined in the Budgetary Act.

## IX. Economic consequences of public debt and taxation

Economic consequences of public debt and taxation are similar. Choosing one of them depends on, *inter alia*, contemporary rate of taxation, the public spending we want to finance in this way and its economic consequence.

Incurring public debt *inter alia*: we receive financial means at once and the cost of servicing public debt is spread in time<sup>34</sup>, but it usually leads to increase of tax rate, creditors can choose the amount of obligations they want to buy, creditors can choose the time of buying obligations, transfers budget incomes from tax to the creditors – in form of debt servicing costs, debt burden for the next generations, causes decrease of global spending power, public debt can be an instrument of changing the structure of economy (*e.g.* financing of capital spending)<sup>35</sup>.

In fact, the choice between public debt and taxation depends on *e.g.*: the contemporary economic situation, the amount of public debt, the aims of economic policy.

The other consequences are connected with taxation. It must be stressed that tax is an obligatory imposition. Taxation *inter alia* causes: lack of cost connected with servicing of public debt. Moreover, after paying a tax taxpayer can spend less money for buying goods (his disposable income is smaller). The exceeding the limit of taxation burden could cause the decrease of budget's tax incomes (dependence illustrated by curve of Laffer). Taxation also leads to impoverishment of taxpayer, tax burden of contemporary generation and the increase of indirect taxation is inflation (tax shifting to prices of foods)<sup>36</sup>.

## X. Statistical data

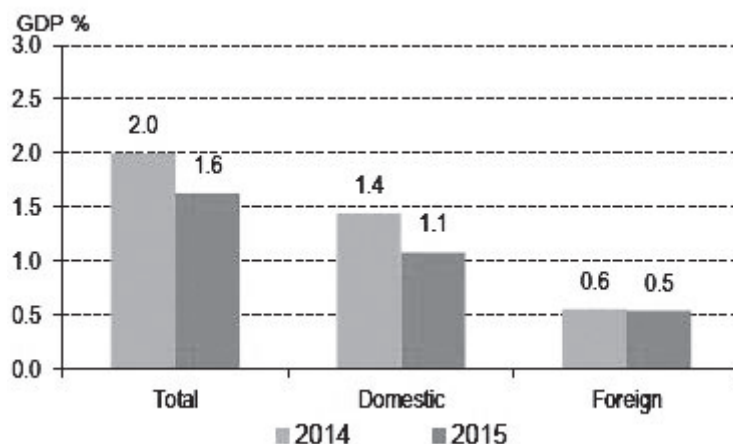
One of the important consequence of taking public debt are debt servicing cost connected with it. Below Figure no 1 shows the State Treasury debt servicing costs in Poland in years 2014-2016. In the year 2015, they were 2% of GDP and decreased to the level of 1,6% of GDP in the year 2016.

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<sup>34</sup> For example, in PFA there is legal definition of expenditures for servicing the State Treasury debt. Expenditures for servicing the State Treasury debt shall in particular consist of state budget expenditures due to interest and discount on treasury securities, interest on drawn credits and loans as well as payments related to guarantees granted by the State Treasury.

<sup>35</sup> RYBARSKI, ROMAN: *Nauka skarbowości* [The Science of Finance], Warsaw, 1935. 363-364. p., GAUDEMET, PAUL MARIE – MOLINER, JOEL: *Finanse publiczne* [Public Finance], Warsaw, 2000. 358-363. p.

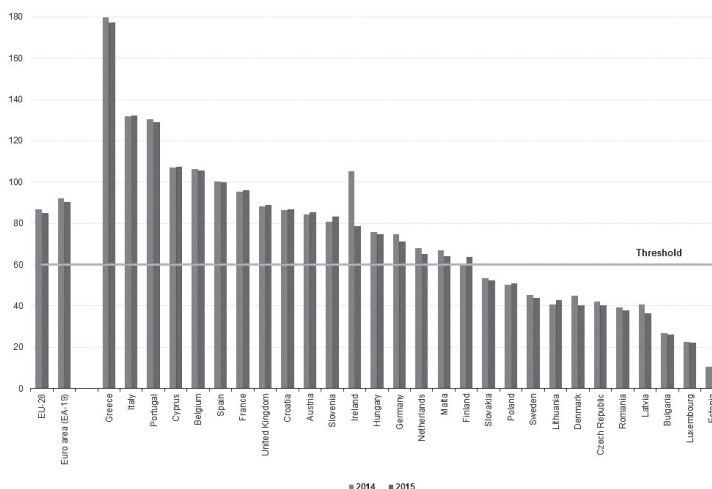
<sup>36</sup> DALTON, HUGH: *Zasady skarbowości*, [The Principles of Public Finance], Łódź, 1948. 216. p.; Gaudemet, Moliner 2000, 358-363. p.



1. The State Treasury debt servicing costs in Poland in years 2014-2016. Source: The Public Finance Sector Debt Management Strategy in the years 2017-2020, Warsaw 2016.

Figure no 2 presents the general government consolidated gross debt in the EU member states in the years 2014-2015 (% of GDP). Only in eleven EU member states the amount of public debt is under the fiscal criterion of debt-to-GDP. In other EU member states the criterion is exceeded. Also, the average amount of public debt in the UE-28 and Eurozone exceeded the public debt limit.

Figure no 3 shows total revenue from taxes and social contributions in the EU-28 and Eurozone-19 in the years 1995-2015.

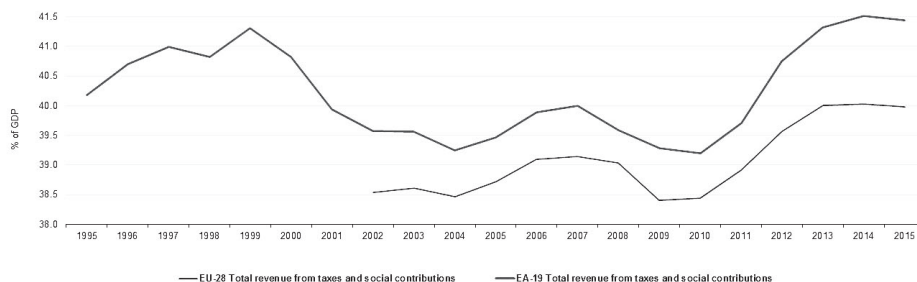


Note: Data extracted on 21.10.2016.  
Source: Eurostat (online data code: tsdde410)

2. General government consolidated gross debt in the member states of the EU in the years 2014-2015 (% of GDP). Source: Eurostat.

Figure no 3 shows total revenue from taxes and social contributions in the EU-28 and Eurozone-19 in the years 1995-2015. In the year 2008, after the financial crisis, the total

revenue and social contributions decreased. Since the year 2010 they started to increase. It can imply, that (especially since the year 2011) in many EU member states the taxation was higher than before the financial crisis and that the economic situation was improving (and, in the result, the taxpayers paid more taxes to the budget).



3. Total revenue from taxes and social contributions, EU-28 and EA-19 % of GDP, 1995-2015. Source: Eurostat.

## XI. Closing Remarks

It is commonplace that the budget balance rule is not respected. The most frequent reason for such state is the budget deficit. It means that the budget spending exceeds the budget revenues (in a period of one year). It can be caused by various factors, for example the economic policy which aims at stimulating the economic activity in the period of global depression. Regardless of the reasons that lie behind the budget deficit, there are two possibilities of limiting it. The first one is to take public debt. One of the biggest drawbacks of that solution is the cost of servicing public debt. The other issue is the reason for taking public debt. It must be stressed that the reasons for taking public debt should be "productive" in economic sense (it means not consumption but investment). Moreover, public debt cannot be taken, if the public debt limits are exceeded (or are close to it). The aim of these limits is the fiscal consolidation (so, in fact, keeping the amount of public debt at the level which is optimal for the national economy). The other solution for increasing state budget revenues is to increase tax rates. This solution also bears specific economic consequences. They depend on the kind of tax (*e.g.* indirect tax such as VAT is a better source of improving budget income than direct tax such as personal income tax). It should be also noticed that the tax rate and budget income depend on theoretical dependence which is illustrated on Laffer's curve - exceeding the limit of taxation burden could cause a decrease in budget tax income. In fact, the choice between public debt and taxation depends on *e.g.*: contemporary economic situation, the amount of public debt, the aims of economic policy. Therefore, the best summary of these problem is the following citation: 'The best proves for original, different character of both kinds of financing – public loan and tax – is that the choice one of them is the most delicate problem of the finance policy. Its solution depends on the justification of the reason of taking the public loan.'<sup>37</sup>

<sup>37</sup> GAUDEMET, MOLINER 2000, 363. p.

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